ST 98-12
Tax Type: SALES TAX
Issue: Disallowed Resale Deduction (No Valid Certificates)
Enterprise Zone (Exemptions)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE	**)**	
OF THE STATE OF ILLINOIS	**)**	
	)	**Docket No.**
v.	**)**	**IBT #**
	)	**Assmt #**
XYZ CORPORATION	**)**	**Claim for Credit or Refund**
Taxpayer	**)**	

RECOMMENDATION FOR DISPOSITION

Appearances: Charles Hickman, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Gerri Papushkewych and David Hall of Wolfson & Papushkewych for XYZ CORPORATION

Synopsis:

The Department of Revenue ("Department") audited XYZ CORPORATION ("taxpayer") for the period from July of 1981 to December of 1991. At the conclusion of the audit, the auditor prepared a corrected tax return that was signed by the taxpayer, and the taxpayer paid the tax that was due. In November of 1992, the Department issued a Notice of Assessment to the taxpayer for the interest that had accrued on the tax plus a penalty. The taxpayer filed a petition with the Board of Appeals ("Board"), and in November of 1993 the Board issued an order remanding the case to the Office of Administrative Hearings.[1] The taxpayer also filed a Claim for Credit or Refund, which was denied by the Department. The taxpayer's protest of the Department's Notice of Tentative Denial of Claim ("Notice") was consolidated with the present case. Although the Notice

was issued after the evidentiary hearing was held in this matter, the parties stipulated that the evidence presented at the hearing would be the basis for reviewing the propriety of the denial of the claim. The following issues were raised by the taxpayer at the hearing: (1) whether the auditor should have used error rates from a different time period as a basis for projecting the taxes owed for the years that the taxpayer did not have books and records; (2) whether the auditor used an incorrect method for determining the amount of taxes owed on inventory purchases; (3) whether the taxpayer is entitled to an abatement of the penalty due to reasonable cause; (4) whether the interest rate applied by the Department contains a component of imputed penalty; and (5) whether the tax, penalty, and interest prior to July 1, 1986 should be abated. After reviewing the record, it is recommended that this matter be resolved partially in favor of the taxpayer and partially in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer is a construction contractor that specializes in mechanical contracting. The taxpayer is located in Champaign, Illinois. (Tr. pp. 63, 68-69, 96)

2. From 1978 to 1983, most of the taxpayer's business was residential construction. During this time period, the taxpayer was known as XYZ Heating & Air Conditioning Company, Inc. (Taxpayer Ex. J-3; Tr. pp. 63-64, 97)

3. In January of 1983, the taxpayer's current president, JOHN DOE purchased the business. The net worth of the business was small when it was acquired by MR. DOE, and the taxpayer was unable to obtain performance bonds. Such bonds were necessary to perform work for certain tax-exempt organizations, such as the State of Illinois. (Tr. pp. 62-66, 81-82)

4. In June of 1984, JOE DOAKS, who is the current vice-president, began working for the taxpayer. He was hired to increase the commercial-industrial segment of the business. (Tr. pp. 65, 95-98)

[1] Although the Office of Administrative Hearings does not have jurisdiction over final assessments, when the Chief Administrative Law Judge agreed to accept the case from the Board, he effectively granted the taxpayer a discretionary hearing pursuant to sections 4 and 5 of the Retailers' Occupation Tax Act. (35 ILCS 120/4, 5; see also 86 Ill.Admin.Code §200.175).

5. Prior to 1985, the taxpayer did virtually no construction jobs for tax-exempt organizations. (Tr. pp. 81, 90, 108)

6. The taxpayer's financial statements show that for fiscal years ending March 31, 1984, 1985, and 1986, the percentage of revenue from residential business was 29.4%, 14.22% and 8.54% respectively. The figures for fiscal years ending March 31, 1987 and 1988 were not available. (Taxpayer Ex. A-3)

7. For fiscal year ending March 31, 1989, the percentage of revenue from residential business was 1.13%. The percentage of revenue from residential business was less than 1% for fiscal years ending December 31, 1989, 1990, and 1991. (Taxpayer Ex. A-3)

8. The taxpayer was not registered to do business in Illinois until April 1, 1989. The taxpayer did not file retailers' occupation tax returns prior to that time. (Tr. pp. 83, 90)

9. The Department audited the taxpayer for the period from July 1, 1981 to December 31, 1991. (Dept. Ex. #1; Tr. p. 15)

10. At the time of the audit, the taxpayer did not have business records for July 1, 1981 to December 31, 1984. The taxpayer's president testified that he destroyed the records because he thought that he did not need to keep records longer than seven years. (Tr. pp. 15, 83)

11. In order to determine the tax liability for July 1981 through December 1994, the auditor examined in detail the taxpayer's purchases between January 1985 through March 31, 1989. The findings were then projected over the period for which there were no records by using a "percentage of error" method. (Tr. p. 26)

12. The auditor used the time period from January 1985 to March 31, 1989 as a basis for the projections because on April 1, 1989 the taxpayer became registered to do business in Illinois. The auditor believed that the time periods of July 1981 to December 1984 and January 1985 to March 1989 were similar because the taxpayer was not registered during either of those periods. (Tr. pp. 54-55)

13. The auditor calculated the percentage of error by first adding the amounts from each of the categories of exceptions in the Global Taxable Exceptions[2] for the time period from January 1985 to March 31,

[2] The "Global Taxable Exceptions" is a document prepared by the Department that lists the items upon which the Department claims the taxpayer owes taxes.

1989. The auditor divided the total from each category of exceptions by the total revenue for the same time period to arrive at an "error rate." He then multiplied this percentage by the taxpayer's total revenue for the periods for which there were no records. (Tr. pp. 26-28)

14. The auditor testified that the percentage of error method was used because the taxpayer's business increased from 1985 to 1991. The alternative method would have been to take an average per month. He stated that this method does not take into account the growth of the business. (Tr. pp. 56-57)

15. The percentage of error method was not used for the enterprise zone exemption exceptions because the enterprise zone exemption was not in effect for Champaign between July of 1981 and December of 1984. (Tr. p. 28)

16. Instead of using the auditor's error rates, the taxpayer's certified public accountant ("CPA"), Denise Martin, calculated separate error rates for each year from 1985 to 1989 and for each of the categories of exceptions. These rates are listed in the taxpayer's Exhibit A-2. The exhibit shows that the error rates were the lowest during 1985 and 1986. The error rates are the highest in 1987 and 1988 and generally decreased in 1989. (Taxpayer Ex. A-2; Tr. pp. 121-123)

17. Ms. Martin calculated the tax owed for 1981 through 1984 using the error rates from 1985 as a basis for projecting the tax. With her calculations she concluded that the taxpayer is entitled to a credit of $9,038 for 1981 through 1984. The Department does not dispute the accuracy of her calculations. (Taxpayer Ex. A; Tr. pp. 109-116; Department's brief p. 6)

18. While reviewing the taxpayer's inventory purchases, the auditor noted that some of the invoices did not have specific job numbers on them. The invoices were for items such as sheet metal that was used for duct work. The taxpayer put these items in an inventory account and made withdrawals when they were needed for a specific job. (Tr. p. 158)

19. After reviewing the invoices for the inventory purchases, the auditor included the items for which no tax was paid in the Global Taxable Exceptions. (Tr. p. 158)

20. The auditor spoke with the taxpayer's representatives concerning the taxpayer's operations and concluded that some of the items that the taxpayer purchased were used on jobs that would allow the taxpayer to avoid paying tax on those items ("tax-exempt" or "nontaxable" jobs).[3] (Tr. pp. 158-59)

21. The auditor decided to review the withdrawals from inventory for a sample period to determine what portion of the inventory was used on tax-exempt jobs. (Tr. p. 159)

22. The auditor examined all of the inventory withdrawals from January 1, 1989 to December 31, 1991 and determined that approximately 44% of the withdrawals were used on nontaxable jobs and 56% on taxable jobs.[4] (Tr. pp. 159-162)

23. The auditor multiplied 44% times the inventory purchases that were included in the Global Taxable Exceptions (i.e., the ones for which no tax was paid). The auditor then credited the Global Taxable Exceptions for this amount. In other words, he reduced the inventory purchases in the Global Taxable Exceptions by 44%. The net effect of this was that roughly 56% of the inventory purchases for which no tax had been paid were included in the Global Taxable Exceptions. (Tr. p. 162)

24. Ms. Martin testified that the 56% should have been applied to the total inventory purchases, which included both the purchases on which the taxpayer paid tax and the purchases on which it did not pay tax. This amount should have been compared to the total amount of purchases on which the taxpayer paid tax. If the amount of purchases on which the taxpayer paid tax was less than 56% of the total purchases, then the difference should have been the amount included in the Global Taxable Exceptions. (Tr. p. 125-129)

25. Ms. Martin testified that she recalculated the tax owed on the inventory purchases by applying the 56% to the total inventory purchases rather than only those purchases on which the taxpayer did not pay taxes. Based on her calculations, she determined that the taxpayer is entitled to a credit of $12,575. (Taxpayer Group Ex. B; Tr. pp. 132-143)

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[3] Section 130.2075(d) of the Department's regulations provides that a construction contractor does not owe ROT or use taxes on property that is converted into real estate that is owned by governmental bodies. (86 Ill.Admin.Code §130.2075(d)) Because some of the taxpayer's construction work was for the State of Illinois, the items purchased for use on those jobs would qualify under this exemption.

[4] The auditor determined that 43.93175% of the withdrawals were used on tax-exempt jobs and 56.06824% on taxable jobs. (Taxpayer Ex. B-3) For simplification purposes, the parties have rounded these to 44% and 56% respectively.

26. The Department stated that it "does not take issue with the computations contained in group Exhibit B," which are the computations concerning the tax relating to the inventory purchases. (Department's brief, p. 10)

27. The relevant enterprise zone exemption became effective in 1985. (Tr. p. 47)

28. MR. DOE received information from the City of Champaign and the Illinois Department of Revenue that led him to believe that the taxpayer's purchases of certain materials that the taxpayer incorporated into real estate qualified for the enterprise zone exemption. (Taxpayer Ex. D, E, G; Tr. pp. 68-72)

29. MR. DOE testified that through a conversation with another local contractor, he learned that his understanding of the enterprise zone exemption might be incorrect. (Tr. p. 74)

30. After learning that there may be some confusion concerning the enterprise zone exemption, MR. DOE contacted his corporate attorney. (Tr. pp. 74-75)

31. The Department prepared a corrected tax return for the audit period in question. The return shows total tax due in the amount of $160,264 plus a penalty of $4,712 and interest calculated through September 20, 1992 in the amount of $71,927. The president of the taxpayer signed the return. A copy of the corrected return was admitted into evidence under the certificate of the Director of the Department. (Dept. Group Ex. #1)

32. The taxpayer paid the tax that the Department determined was owed as a result of the audit and subsequently filed a Claim for Credit or Refund. (Tr. p. 114)

33. On November 19, 1997, the Department issued a Notice of Tentative Denial of Claim, which denied the taxpayer's total claim in the amount of $59,501. A copy of the Notice of Tentative Denial of Claim was allowed into evidence under the certificate of the Director of the Department. (Dept. Ex. #3)

CONCLUSIONS OF LAW:

The Use Tax Act (35 ILCS 105/1 *et seq.*) imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. Section 12 of the Use Tax Act incorporates by reference sections 4 and 5 of the Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq.*), which provide that the corrected return issued by the Department is *prima facie* correct and is *prima facie* evidence of the correctness of the amount of tax due, as shown therein. 35 ILCS 105/12; 120/4, 5. Section 12

also incorporates section 6b of the ROTA, which provides that the Department's Notice of Tentative Denial of Claim constitutes *prima facie* proof of the correctness of the Department's determination, as shown therein. 35 ILCS 105/12; 120/6b.

Once the Department has established its *prima facie* case by submitting a certified copy of the corrected return and Notice of Tentative Denial of Claim into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. Clark Oil & Refining Corp. v. Johnson, 154 Ill.App.3d 773, 783 (1st Dist. 1987). To prove its case, a taxpayer must present more than its testimony denying the Department's assessment. Sprague v. Johnson, 195 Ill.App.3d 798, 804 (4th Dist. 1990). The taxpayer must present sufficient documentary evidence to support its claim. Id.

Comparable Period for Projections

The first issue is whether the auditor should have used the error rates from 1985 instead of 1985 through 1989 as a basis for projecting the amount of tax owed for the period from July 1981 to December 1984. Because the taxpayer had no books and records available for 1981 through 1984, the auditor categorized the exceptions from January 1, 1985 to March 31, 1989, determined error rates for this time period, and used the rates to project the amount of tax owed for 1981 through 1984. The taxpayer argues that the auditor should have used only the error rates from 1985 as a basis for the projections because the taxpayer's business prior to 1985 more closely resembled the taxpayer's business in 1985 than the taxpayer's business from 1985 to 1989. The taxpayer contends that the higher rates of error in 1987 and 1988 were due solely to the change in the taxpayer's operations. The taxpayer therefore claims that in preparing the corrected tax return, the auditor should have used the low rates of error from 1985.

Under the ROTA, the Department is required to correct the tax return according to its "best judgment and information." 35 ILCS 120/4. There is no requirement that the Department substantiate the basis for its corrected return at the hearing. Masini v. Department of Revenue, 60 Ill.App.3d 11, 14 (1st Dist. 1978). When the corrected return is challenged, however, the method that was used by the Department in correcting the return must meet a minimal standard of reasonableness. Id.; Elkay Manufacturing Co. v. Sweet, 202 Ill.App.3d 466, 470 (1st Dist. 1990).

The president of the taxpayer testified that most of the taxpayer's business from 1978 to 1983 was residential construction. When he acquired the business in 1983, his goal was to expand the commercial portion of the business, which included both taxable and tax-exempt jobs. At that time, the net worth of the company was so small the taxpayer could not acquire performance bonds that were necessary to bid on certain tax-exempt jobs, such as those for the State of Illinois. During 1984 and 1985 the taxpayer began to expand its commercial work, which included doing more tax-exempt work. The tax-exempt work allowed the taxpayer to purchase materials without paying tax directly to its vendors. The auditor determined that from 1989 to 1991, approximately 44% of the taxpayer's jobs were tax-exempt. In addition, by the late 1980's the taxpayer no longer accepted new residential customers; the taxpayer only did service work for prior residential customers. (Tr. p. 68) During 1991, none of the taxpayer's revenue was from residential work.

Even though the focus of the taxpayer's business may have changed from residential to commercial, it is not clear that the business in 1985 more closely resembled the business prior to 1985. From April 1, 1984 to March 31, 1985, the taxpayer earned only 14.22% of its revenue from residential work. The switch from residential jobs to commercial jobs was therefore substantially completed by December of 1984. Also, the president testified that the tax-exempt work began to increase in 1985. If the taxpayer had done virtually no tax-exempt work prior to 1985, then the business prior to 1985 would not necessarily resemble the business in 1985. In addition, there appears to be no direct correlation between the increase in the commercial and/or tax-exempt work and the increase in the error rates. Some of the error rates decreased in 1989 while the commercial and tax-exempt work continued to rise. The taxpayer's witnesses testified that the high error rates in 1987 and 1988 might have been the result of employee confusion concerning the taxability of certain transactions, especially those concerning the enterprise zone exemption. Thus, there seems to be no correlation between the error rates and the change in the taxpayer's customers.

Moreover, the taxpayer has not shown that the auditor's method for preparing the corrected tax return was unreasonable. The auditor used the time period from January 1, 1985 to March 31, 1989 as a basis for projecting the tax because the taxpayer was not registered to do business in Illinois during that time. The auditor explained that without being registered, the taxpayer was unable to provide a resale certificate during

that time; this time period was therefore similar to the 1981-84 period. He also stated that he was not able to determine whether 1985 was more similar to 1981 through 1984 than 1985 through 1989 because there were no records prior to 1985 from which comparisons could be made. (Tr. p. 56) The auditor noticed the business grew substantially over the years, and he therefore used a percentage of error method rather than taking an average per month. The auditor's method used in calculating the taxes owed for 1981 to 1984 meets a minimum standard of reasonableness.

Inventory Purchases

The next issue is whether the auditor used an incorrect method for determining the amount of tax owed on inventory purchases. The auditor testified that he reviewed the inventory invoices and included the purchases for which no tax was paid in the Global Taxable Exceptions. After discussing the taxpayer's operations with its representatives, the auditor concluded that some of the taxpayer's construction jobs were tax-exempt, and therefore the taxpayer would not owe tax on the items that were used on those jobs. The auditor decided to examine in detail the inventory withdrawals for the sample period of January 1, 1989 to December 31, 1991. He concluded that approximately 44% of the withdrawals were used on nontaxable jobs. He then multiplied 44% times the inventory purchases that were included in the Global Taxable Exceptions and gave the taxpayer a credit for this amount. The net effect was that approximately 56% of the inventory purchases for which the taxpayer did not pay tax were included in the Global Taxable Exceptions.[5]

The taxpayer argues that the 56% should have been applied to the total number of purchases instead of only the purchases on which the taxpayer did not pay tax. Because the auditor reviewed the total inventory withdrawals for the sample period, he should have applied the percentage of taxable jobs to the total purchases to keep the populations consistent. The taxpayer claims that the auditor started using a formula to determine the taxpayer's proper liability and then abandoned the method midway through its application. The taxpayer contends that this is an illogical method for determining the liability, and it results in an overstatement of the tax

[5] It is noteworthy that the auditor chose the last three years of the audit period as the sample period for reviewing the inventory withdrawals; this selection most likely resulted in a lower percentage of taxable purchases. The taxpayer's witnesses stated that prior to 1985 the taxpayer did virtually no tax-exempt work, and therefore all of the inventory purchases during that time period would have been taxable. Sometime during 1985 the taxpayer began to do tax-exempt work, and this work continued to increase throughout the audit period. Therefore, the percentage of tax-exempt work was probably greatest during the last three years of the audit period.

liability. The Department argues that the effect of the method proposed by the taxpayer is to allow the taxpayer a credit for tax paid in error to its vendors.

The auditor's method results in an overstatement of the tax liability, and therefore is an incorrect method for determining the liability on the inventory purchases.[6] After concluding that 56% of the inventory withdrawals during the sample period were used on taxable jobs, the auditor should have applied this percentage to the same population, i.e. the **total** purchases, in order to properly project the amount of taxable purchases for the audit period. The auditor incorrectly applied the results from the sample period to the wrong population in the audit period. The effect of the auditor's method is an overstatement of the amount of taxes owed, which is illustrated by the following example. If the taxpayer purchased $100,000 worth of inventory during the audit period and paid tax on $60,000 of those purchases, then the auditor in this case would have applied the 56% to the remaining $40,000 of inventory items for which tax was not paid and included that amount in the Global Taxable Exceptions. This results in an additional $22,400 (56% x $40,000) on which the Department assessed taxes. If the auditor had applied the 56% to the total purchases of $100,000 and compared that amount ($56,000) to the $60,000 that the taxpayer had already paid tax on, then there would be no need to assess the taxpayer any additional tax. Under this example, the auditor's method results in an additional $22,400 on which tax would be assessed (i.e., an over-assessment of $22,400 times the applicable tax rate).

The auditor testified that he did not apply the 56% to the total purchases because the effect would be to give the taxpayer a credit for use tax paid in error to its vendors. The auditor correctly states the general proposition of law that only the party who actually remits the tax to the Department is entitled to a credit. Section 6 of the ROTA, as incorporated by section 12 of the Use Tax Act, provides that a credit or refund may be given "to the person who made the erroneous payment." 35 ILCS 105/12; 120/6. See also 86 Ill.Admin.Code, §130.1501(a)(1) ("Where a taxpayer *** pays to the Department an amount of tax *** not due *** such taxpayer may file a claim for credit ***"). The taxpayer may claim a credit or refund of use tax paid

[6] The auditor apparently tried to reduce the taxpayer's liability by applying this method. After the auditor reviewed the invoices and included the purchases for which no tax was paid in the Global Taxable Exceptions, generally the taxpayer then must show why it does not have to pay tax on those purchases. The auditor testified that the invoices did not have job numbers on them, and there was no way to determine which withdrawals related to which original invoice. (Tr. p. 166) Nevertheless, because the auditor chose this method, it must be correctly applied.

in error from its vendors. See 35 ILCS 105/3-45. Therefore, under the previous example the Department could not give the taxpayer a credit for the difference between what the taxpayer paid and what he should have paid (i.e., the Department is not allowed to give the taxpayer credit for the $4,000 difference between the $60,000 and the $56,000).

Nevertheless, in this case the auditor's method resulted in the taxpayer being assessed more than it should have been assessed, and the effect of the taxpayer's calculations does not result in a credit for use taxes paid to the vendors. As previously stated, the proper method for determining the tax would be to apply the 56% to the total inventory purchases and compare this amount to the purchases on which the taxpayer paid tax. If the comparison shows that the taxpayer paid less tax than it should have paid, then the difference should be included in the Global Taxable Exceptions. If the comparison shows that the taxpayer paid more tax than it should have paid, then the Department should not assess the taxpayer any additional tax. Because the Department cannot give a credit for use tax erroneously paid to the vendors, the Department would not be allowed to give a credit to the taxpayer for the difference between what it paid to the vendors and what it should have paid.

According to the taxpayer's calculations, the taxpayer's total inventory purchases between 1989 and 1991 were $805,020. (Taxpayer Ex. B, p. 2A) When this amount is multiplied by 56.06824%, which is the exact percentage that the auditor used, the result is $451,361. This is the amount on which the taxpayer should have paid taxes. The auditor had determined that the taxpayer did not pay tax on $405,550 of the purchases between 1989 and 1991. (Taxpayer Ex. B) Therefore, the taxpayer actually paid tax on $399,470 of the purchases between 1989 and 1991 (i.e., the total purchases of $805,020 minus $405,550). Because the taxpayer should have paid tax on $451,361 and only paid tax on $399,470, the difference of $51,891 is the amount that should have been included in the Global Taxable Exceptions. Instead, the auditor included $225,510[7] in the Global Taxable Exceptions as the amount of the inventory purchases between 1989 and 1991 on which the

[7] The auditor calculated this amount by taking the total amount on which the taxpayer did not pay tax, $405,550, and multiplying that by 56.06824%, which equals $227,385. The auditor then reduced this amount to give the taxpayer a deduction for the cash discount that it takes when purchasing the items to arrive at the amount of $225,510.

taxpayer owes use taxes (Taxpayer Ex. B). Thus, the auditor over-assessed the taxpayer by including an additional $173,619 ($225,510 minus $51,891) for the inventory purchases between 1989 and 1991.

In this case, a comparison of what the taxpayer paid tax on and what the taxpayer should have paid tax on for 1989 through 1991 indicates that the taxpayer paid less tax than it should have paid, and that difference should have been included in the Global Taxable Exceptions. For the remaining years, the taxpayer's CPA used a allocation method that was not disputed by the Department. The Department only contends that the effect of the method is to allow the taxpayer a credit for tax paid in error to its vendors. Because the taxpayer's calculations for 1989 through 1991 indicate that the taxpayer would not be receiving a credit for tax erroneously paid to vendors (i.e., the Department over-assessed the taxpayer for those years) and the Department does not dispute the remaining calculations, it is recommended that the taxpayer receive a credit in the amount determined by the taxpayer's CPA, $12,575.

Waiver of Penalty

Next, the taxpayer claims that it is entitled to a waiver of the penalty due to reasonable cause. The penalty may be abated if the taxpayer establishes "reasonable cause" for the failure to file the tax return. Ill.Rev.Stat., ch. 120, par. 439.12, par. 444. Once the enterprise zone exemption became effective, the taxpayer's president received an informational bulletin from the Illinois Department of Revenue that explained the exemption. Under the explanation given, MR. DOE believed that the taxpayer was a "retailer" under the exemption and certain purchases qualified for the exemption. He also received information from the City of Champaign that led him to the same conclusion. There appears to have been widespread confusion concerning the applicability of the exemption that was not clarified until the decision in Craftmasters, Inc. v. Department of Revenue, 269 Ill.App.3d 934 (4th Dist. 1995) (construction contractor's incorporation of materials into real estate is a use of the materials by the contractor and not a sale of the materials to the contractor's customers). The circuit court's decision in Craftmasters was against the Department, and therefore contractors had relied on that decision in determining their tax liability. Because of the widespread confusion concerning the applicability of the exemption, it is recommended that the penalty be abated.

Interest Rate

The taxpayer argues that the interest rate applied by the Department does not reflect a true market rate of interest and by implication contains a component of imputed penalty. The Department claims that the interest is statutory and there is no authority for its abatement.

An agency only has authority given to it by the legislature through the statute. Davis v. Chicago Police Board, 268 Ill.App.3d 851, 856 (1st Dist. 1994). Because this tribunal has no statutory authority to reduce the interest rate applied in this case, it cannot be recommended that the rate be reduced.

Taxes, Penalty, and Interest Prior to 7/1/86

The taxpayer's last argument is that it is inequitable and unconscionable to assess any taxes, penalty, and interest for the time periods prior to July 1, 1986. The taxpayer claims that dismissing the portion of the assessment that accrued prior to July 1, 1986 would be consistent with the legislative intent evidenced by section 12 of the Use Tax Act, which was amended effective September 16, 1994 and limits use tax assessments to six years for taxpayers who have not filed returns.

As previously stated, an agency's authority cannot extend beyond the authority given to it by the legislature. Because there is no statutory authority to apply equitable principles in this matter, it cannot be recommended that the tax and interest prior to July 1, 1986 be abated.

Recommendation:

For the foregoing reasons, it is recommended that the taxpayer receive a credit in the amount of $12,575 for the auditor's error in calculating the tax owed on the inventory purchases. It is further recommended that the penalty be abated and the remaining tax liability be affirmed.

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Linda Olivero
Administrative Law Judge

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